

FRANCHISE LAW

VIRTUAL SUMMIT

August 12-13, 2020

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CONSPIRACY THEORIES: ESTABLISHING THIRD PARTY LIABILITY IN FRANCHISE LITIGATION

Common Third Party Liability Scenarios in Franchising

- I. Tortious Interference**
- II. Enforcing Restrictive Covenants Against Nonsignatories**
- III. Misappropriation of Trade Secrets**
- IV. Contributory Trademark Infringement**
- V. Civil Conspiracy**

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I. TORTIOUS INTERFERENCE

Elements of Tortious Interference

Generally:

1. **Valid** contract or business expectancy
2. Defendant had **knowledge** of such contract/expectancy
3. Intentional **and** unjustifiable interference
4. Resulting **damage**

First Element: Best Bet is an Established Contract

Existing contract better than a prospective one.

First Element: Prospective Economic Advantage

Prospective Economic Advantage Counts

- “Something less than a contractual right [but] something **more than a mere hope**”
- Must demonstrate “objectively reasonable probability that a contract will come into existence”
- Past customers and public **don’t** count

Second Element: Knowledge

- Interfering party must have **knowledge** of facts giving rise to a contractual relationship
- **Regardless** of whether it:
 - Appreciates legal significance of such facts,
 - Believes there is no contract; or
 - Believes contract has different meaning
- Shutting one's eyes or avoiding making reasonable inquiry with a conscious **purpose to avoid** is the same as knowledge.

Third Element: Intentional Breach

Anything short of actual breach **not** actionable

Some courts hold that **equivalent of breach** will suffice:

- **Economic coercion** to modify original agreement;
- **Rendering** plaintiff's obligations more **onerous**;
and
- Preventing plaintiff from **realizing full benefit** of established contract

Third Element: Unjustified Breach

Justification factor **heavily litigated**

Fact-intensive and **examines defendant's conduct, motive, and "interests it sought to advance"**

Also examines:

- **Nature** of interest with which defendant interfered;
- **Balance** of freedom of action vs. contractual expectation;
- **Proximity** of actor's conduct to interference; and
- **Relationship** of parties

Third Element: Unjustified Breach

- Parties entitled to be secure in their contracts, free of interference, **except** where others act in pursuance of **superior or equal right**
- Competition is justified, proper, and privileged when:
 - Acting to protect interests;
 - Methods were not improper; or
 - Motive not malicious

Third Element: Unjustified Breach

Q: What if interfering party was approached by party to contract?

A: Likely depends on “**but for**” causation (would the contract have been breached anyway) or if third party’s **only act** was to accept offer (e.g. “moving force”).

Fourth Element: Actual Damage

No actual harm = no liability

Injunctive relief

Advice of Counsel

- Complete defense in some states but merely a negating factor of intentionality in other states
 - Full disclosure; and
 - Complete reliance

Preventive Measures

Emphasize the following :

- Franchisor cannot enter into agreement with prospective franchisee until franchisee's **current obligations** fulfilled;
- Need to know expiration date of current agreement;
- Confirm salesperson **did not defame** existing franchisor;
- Need for franchisee sign-off; and
- Need for development training.

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II. ENFORCING RESTRICTIVE COVENANTS AGAINST NONSIGNATORIES

Enforcing Restrictive Covenants Against Nonsignatories

Common Scenarios

- A former franchisee rebrands and operates a competing business through a new corporate entity
- A family member of a former franchisee starts a competing business
- A previously undisclosed owner of a franchise opens a competing business

Enforcing Restrictive Covenants Against Nonsignatories

Circumstances warranting enforcement

- Noncompete signatory effectively controls nonsignatory
- Evidence of conspiracy to violate or aiding and abetting a violation
- Nonsignatory substantially benefited from the franchise agreement
- **Fed. R. Civ. P. 65(d)(2):** Injunction/TRO may bind “the parties, the parties’ officers, agents, servants, employees, and attorneys; and other persons who are in active concert or participation”

Enforcing Restrictive Covenants Against Nonsignatories

Noncompete signatory controls nonsignatory

- *Relo Franchise Services, Inc. v. Gilman*, 2018 WL 7288084 (S.D. Ohio Oct. 5, 2018), *R & R adopted*, 2019 WL 324215
- *U.S. Lawns, Inc. v. Landscape Concepts of CT, LLC*, 2016 WL 9526340 (M.D. Fla. Oct. 31, 2016)

Enforcing Restrictive Covenants Against Nonsignatories

Evidence of conspiracy to violate or aiding and abetting violation

- “[T]he rule that a stranger to a covenant may be enjoined from aiding and assisting the covenanter in violating his covenant is supported by an overwhelming weight of authority.” *McCart v. H&R Block, Inc.*, 470 N.E.2d 756 (Ind. Ct. App. 1984) (citation omitted)
- *The Maids Int’l, Inc. v. Maids on Call, LLC*, 2017 WL 4277146 (D. Neb. Sept. 25, 2017)
- *Tanfran, Inc. v. Aron Alan, LLC*, 2007 WL 1796235 (W.D. Mich. June 20, 2007)

Enforcing Restrictive Covenants Against Nonsignatories

Nonsignatory substantially benefited from franchise agreement

- *Cajun Global LLC v. Swati Enterprises., Inc.*, 283 F. Supp. 3d 1325 (N.D. Ga. 2017)
 - “[W]hile it is true that non-signatories are generally not bound by contracts, traditional principles of state law may allow a contract to be enforced by or against nonparties to the contract through assumption, piercing the corporate veil, alter ego, incorporation by reference, third party beneficiary theories, waiver and estoppel.”
- *Little Caesar Enterprises, Inc. v. Little Caesar’s Va., Inc.*, Bus. Franchise Guide (CCH) ¶ 14,199 (Aug. 27, 2009)

Enforcing Restrictive Covenants Against Nonsignatories

Example of Refusal to Enforce Noncompete Against Nonsignatory

- *Winmark Corp. v. Brenoby Sports, Inc.*, 32 F. Supp. 3d 1206 (S.D. Fla. 2014), adopting R & R, 2014 WL 11350212
 - Former franchisee enjoined from maintaining interest in competing business
 - However, relationship between competitor and former franchisee and its principals too tenuous to enforce noncompete against nonsignatory

Enforcing Restrictive Covenants Against Nonsignatories

Practice Pointers

1. Name nonsignatory as a party
2. Get more signatures, *e.g.* guarantees from franchisee's principals

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III. MISAPPROPRIATION OF TRADE SECRETS

Misappropriation of Trade Secrets by Third Parties

- **Common Scenarios**

- Former franchisee creates new entity that uses franchisor's trade secrets
- Franchisee's employees use the trade secrets to unfairly compete
- Family members use the trade secrets

Misappropriation of Trade Secrets by Third Parties

Practice Pointers

- Clearly and carefully define trade secrets in the franchise agreement
- Consider obtaining a declaratory judgment on ownership and confidential nature of the trade secret

Defend Trade Secrets Act (“DTSA”)

- Federal protections effective 2016
- Trade secrets related to **interstate or foreign commerce**
- Plaintiffs need no other basis for **federal jurisdiction**, if more favorable than state trade secret laws
- Power to order *ex parte* **seizure** of property
 - *Vice Capital, LLC v. CBD World, LLC*
- Extra relief perks: **injunction**, \$ damages, **double** damages and attorneys’ fees for willful/malicious misappropriation

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IV. CONTRIBUTORY TRADEMARK INFRINGEMENT

Contributory Trademark Infringement

- May allow for a claim against a landlord who continues to display franchisor's trademarks after franchisee fails to de-identify
 - A useful tool when the franchisee is insolvent or has abandoned the premises

Contributory Trademark Infringement: *Luxottica Grp., S.P.A. v. Airport Mini Mall* (11th Cir. 2019)

- Owner of Ray Ban and Oakley trademarks sues owner of a flea market for contributory trademark infringement
 - Flea market was subject to frequent raids by law enforcement for the sale of counterfeit goods

Elements

1. Defendant had **sufficient control** over infringement
2. Defendant **knew** of infringement activity
3. Defendant **continued to supply** service despite such knowledge
4. Defendant failed to **take steps to stop** activity

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V. CIVIL CONSPIRACY

Plus: When Third Party Interference Is Civil Conspiracy

In addition to third party interference claims, franchisors may also claim **civil conspiracy**

- Generally, combination of 2+ people perform unlawful act, *or* legal act by unlawful means, with **intent to injure** and **lack of justification**

Recognition varies state by state

- Usually cannot be stand-alone claim; combine with 1+ other interference cause(s) of action

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